

Internal Revenue Service  
**memorandum**

CC:TL-N-8577-91

Brl:JCALbro

date: AUG 22 1991

to: Regional Counsel, [REDACTED] CC: [REDACTED]  
Attn: [REDACTED]

from: Assistant Chief Counsel (Tax Litigation) CC:TL

subject: [REDACTED]

Dismantlement Costs of [REDACTED]

This is in response to your request for litigation advice dated July 9, 1991, concerning the above-mentioned case. You requested our evaluation of the positions you propose to take in a motion for partial summary judgment regarding [REDACTED]'s claims for deductions in the years [REDACTED] through [REDACTED] for dismantlement and restoration costs of the [REDACTED] facilities.

ISSUES

1. Whether a partnership's election under Treas. Reg. § 1.167(a)-11(a)(1) to depreciate assets placed in service during the years [REDACTED] through [REDACTED] under the ADR system precludes the allowance of a deduction by a partner under I.R.C. § 162 for the estimated future costs of dismantling and removing such assets?
2. Whether a partner's claim for a deduction of estimated future costs of dismantling and removing such assets would render the partnership's ADR election invalid or subject to revocation?
3. Whether a collateral agreement resolving certain issues relative to [REDACTED] ([REDACTED]) constitutes a waiver relative to the ADR regulations as it pertains to the treatment of dismantlement costs?

CONCLUSIONS

1. A partnership's election to depreciate assets using the ADR system precludes the allowance of a deduction by a partner under I.R.C. § 162 for the estimated future costs of dismantling and removing such assets prior to the process of retirement of such assets.
2. A partner's claim for a deduction of estimated future costs of dismantling and removing assets does not render the partnership's ADR election invalid or subject to revocation.

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3. The language in the collateral agreement should not constitute a waiver of the provisions of the ADR regulations concerning dismantlement.

#### FACTS

We have summarized the facts as set forth in your request for advice as follows. The participants in the [REDACTED] ([REDACTED]) [REDACTED] elected to treat [REDACTED] as a partnership for tax purposes. The Forms 1065 elect the ADR system of depreciation for most of the [REDACTED] [REDACTED] equipment and facilities placed in service for the years in issue. The electing Forms 4832 provide that by filing the form taxpayer elects, consents and agrees to apply the provisions of Treas. Reg. § 1.167(a)-11. [REDACTED] seeks a deduction for the estimated future costs of dismantlement and restoration of the [REDACTED]. [REDACTED]'s position is that the [REDACTED] and applicable state and federal statutes and regulations impose the dismantlement and restoration requirements for the [REDACTED] facilities.

The [REDACTED] operating agreement provides that depreciation is allocated to each partner in accordance with the partner's contribution to the adjusted basis of the property and as may be adjusted for retirements. A collateral agreement entered into by the [REDACTED] participants and Appeals provides that the Owners may file refund claims regarding items not addressed in the RAR or attached memorandum, such as dismantlement or restoration costs for the [REDACTED] facilities.

#### DISCUSSION

1. We agree with your analysis of this issue and offer the following comments. We agree that the claimed deduction of estimated dismantlement costs conflicts with Treas. Reg. § 1.167(a)-11(d)(3)(x) because the costs of dismantling an asset is not to be deducted until the asset is in the process of retirement. And, of course, a retirement occurs when an asset is permanently withdrawn from use. Treas. Reg. § 1.167(a)-11(d)(3)(i).

With respect to the "paid or incurred" language of Treas. Reg. § 1.167(a)-11(d)(3)(x) and the fact that dismantlement costs could be paid or incurred prior to an asset being retired, the fact remains, though, that a reasonable interpretation of the regulation limits the expense, which is deductible in the year paid or incurred, to dismantlement costs of an asset in the process of retirement. In the process of retirement defines when the expense is recognized; the paid or incurred language refers to the accounting timing of the deduction once the asset is in the process of retirement and

dismantlement has become a recognized expense pursuant to the regulation.

2. We concur with your discussion of the applicable regulations, and your conclusion that a partner's claim for a deduction which is inconsistent with the partnership ADR election does not render the election invalid or subject to revocation.

3. We concur with your view that the collateral agreement, by merely putting in writing the existing right of the owners to file refund claims on issues not explicitly resolved by the agreement, cannot be construed as a waiver of ADR regulations by the Service.

If you have any further questions concerning this matter, please contact Joyce C. Albro at FTS 566-3442.

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